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To: The Governor's Advisory Council on School Funding

From: Amy Carlson
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RE: Tax equity effects of removing HB124 block grants from district general fund budgets and redistribution options for these state funds.

As discussed in the paper by Judy Paynter of the Department of Revenue, HB 124 block grants were not considered by the legislature to be a permanent solution to replacing revenue lost to districts from tax reductions and other changes incorporated in HB 124. This paper considers how tax equity is affected if the HB 124 block grants were eliminated. As described in the paper presented on HB 124 block grants at the September meeting, the districts with higher taxable values tend to have larger HB 124 block grants. As a result of this distribution, tax equity is improved when the HB 124 block grants are eliminated.

The second section of this paper considers the options for using the HB 124 block grant funds within the school funding formula instead of block grants.

Section 1: Tax Equity and HB 124 Block Grants

As a result of the current funding formula, tax equity can be improved by removing HB 124 reimbursements from the GTB area of school district general fund budgets.

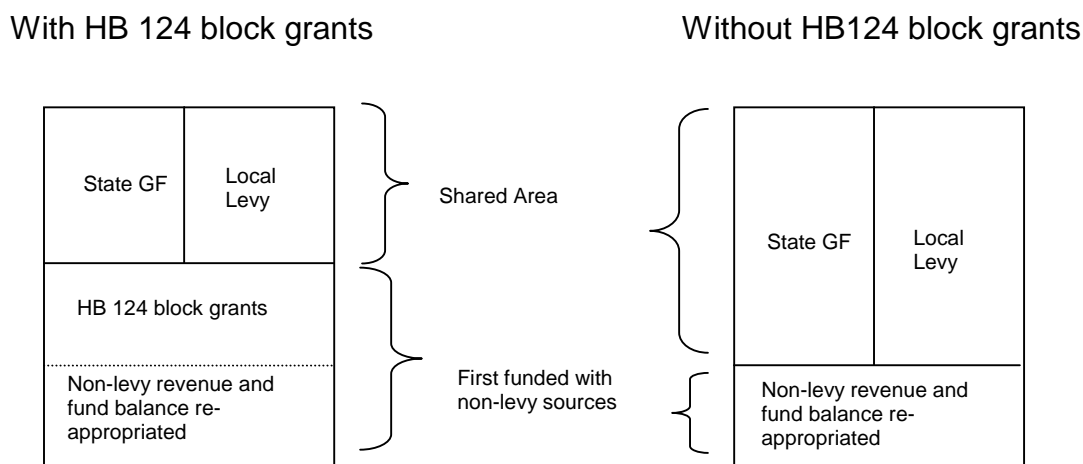
How block grants impact the general fund formula

Block grants are treated like all other non-levy revenue sources. Non-levy revenue and fund balance re-appropriated are the first funding source for the GTB area; they are used to fund this area before any mills are levied. After the non-levy revenue and fund balance re-appropriated are subtracted from the GTB area of the budget, then the number of mills needed to fund this area is determined. The state subsidizes each local mill at a rate that is dependent on the taxable value and size of the GTB area of

the district. The districts with large taxable values relative to their GTB area receive little or no subsidy for each mill. Districts with less taxable value relative to the district GTB area receive a higher subsidy per mill.

The following graphic illustrates how HB 124 block grants impact the GTB area. Note that if the combined sources of non-levy revenue including HB 124, and fund balance re-appropriated meet or exceed the GTB area, no mills are needed to fund the GTB area.

Graphic 1 - District GTB area funding with and without HB124 block grants:



If the \$43.6 million HB 124 block grants to the district general fund are eliminated, then they will no longer be used to fund the district GTB area. The funding formula then requires the number of district mills to increase. Local taxes and the state GTB subsidy will increase with each additional mill that is levied.

Currently the shared area of the GTB budget is typically split 50% state and 50% local. Because the calculation to determine the state share is done on a district-by-district basis and because districts with relatively high property value, which are receiving a lower than average GTB aid from the state, receive a greater share of the HB 124 block grant the split between the state and local district is lower. The state share of the cost to replace the removed block grants is \$18.1 million or 41.5%, and it will require an increase in district levies of \$25.5 million or 58.5% of the \$43.6 million.

The elimination of the \$43.6 million expenditure for block grants, offset by the increase in GTB aid increases of \$18.1 million leaves \$25.5 million in state general fund for schools that can be used to further improve tax equity or address other school funding concerns. That redistribution will be considered in the second section of the report.

Definition

Note that the area of the GTB that is funded by local mills and state subsidy will be called the “shared area” (see Graphic 1). The percentage the “shared area” is of the GTB budget will be called the “shared percentage” of the GTB budget.

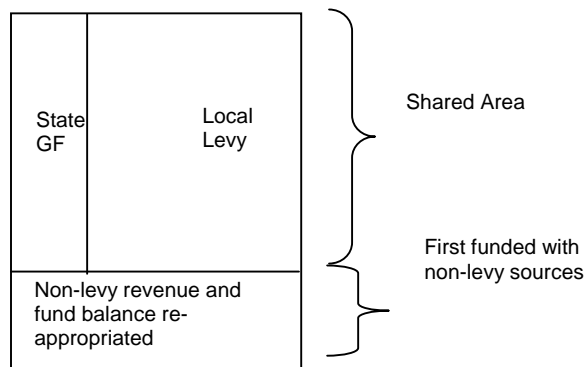
Reasons for inequity

The mills that are required to fully fund the GTB budget of the district vary for two primary reasons:

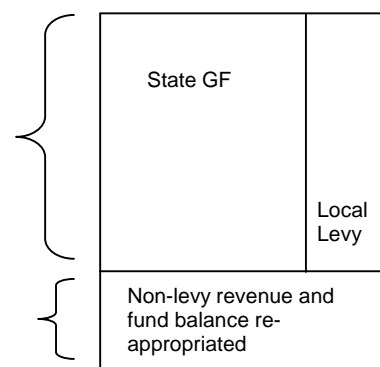
- 1) The greater the share of GTB budget that must be funded with a levy the greater the tax equity. Graphic 1 on the previous page demonstrates how a reduction in non-levy revenue creates a greater percentage of the budget funded with mills. If a district has a significant portion of its budget funded with either non-levy revenue or fund balance re-appropriated, the number of mills required to be levied is lower and in some cases, zero.
- 2) The second cause for fewer than typical mills is the taxable value of the district may be above the guarantee level. If the taxable value of a district is higher than the state guarantee level, then the district will need to levy fewer mills than most districts in order to fully fund the GTB budget. The following examples illustrate this funding.

Graphic 2 – Comparing higher and lower state contribution rates for each mill levied

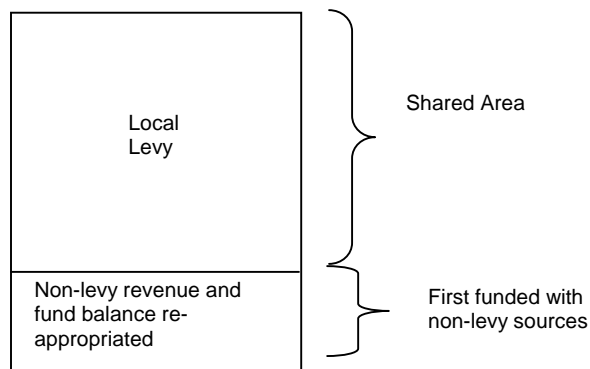
Low state subsidy per mill
Levy **50** local mills



High state subsidy per mill
Levy **50** local mills



No state subsidy per mill
Levy **20** local mills



Note - The example to the left has no state revenue supporting the GTB area of the budget. This district would have a very large taxable value relative to its GTB area and would not qualify for GTB aid. Due to the very high taxable value, the local levy is less than the districts with state GTB aid.

Analysis of Tax Equity when HB124 block grants are removed

Under current law, the average elementary district has a “shared percentage” of 60% and the average high school district has a “shared percentage” of 68%. The remaining 32-40% is funded with non-levy revenue and fund balance re-appropriated.

Individual districts “shared percentage” of the GTB budget varies from 0% to 99% in elementary and also in high school districts. This demonstrates that districts receive non-levy revenue and fund balance re-appropriated that varies between 1% and 100% of the GTB area of the budgets. Two-thirds of the districts have GTB “shared percentages” between 60% and 100%. When HB124 block grants are removed, two thirds have GTB “shared percentages between 80% and 100%. This represents a significant narrowing of the range of GTB budgets supported by mills.

Table 1 summarizes these results:

Number of Districts with Various Shared Percentages				
Table 1				
Percentage Group	Current Law		Without HB124	
	Elementary	High School	Elementary	High School
0%	28	6	21	1
1 -20%	13	5	4	5
20 - 40%	34	4	13	6
40 - 60%	53	26	26	7
60 - 80%	125	66	56	30
80 - 100%	85	58	218	116

When more districts have similar portions of the GTB budget that are “shared” with district and state taxpayers, there will be more equity between the number of mills that each district must levy and therefore greater taxpayer equity. This concept was illustrated in Graphic 1 on page 2.

Comparison of distribution of mills

Similar to congregation of districts at the shared percentage of the GTB area of the general fund budget, when the block grants for HB124 are removed there is a congregation of the number of districts toward the same number of mills.

Table 2 shows the distribution of districts at various mill levels. The significant concentration of elementary schools levying 50-60 mills and high schools levying 30-40 mills illustrates the effect of eliminating HB 124 block grants on tax equity.

Number of Districts at Various BASE Mill Levy Levels

Table 2

Mills	Elementary		High School	
	Current	Remove HB124	Current	Remove HB124
Zero	28	21	6	1
1-10	32	22	7	8
10-20	46	32	26	10
20-30	46	32	84	50
30-40	53	35	42	96
40-50	95	69		
50-60	33	115		
over 60	4	11		

The districts that continue to have zero mills even after HB124 block grants are removed tend to be anomalies. Some have a high taxable value relative to their GTB budgets causing a low state share of the GTB area. Some tend to allow large fund balances to roll forward to offset the next year's BASE budget and thus have no BASE mills. Some are very low spending districts and may have actual expenditures less than the BASE budget. Some are higher spending and have a large non-levy revenue source such as oil and gas or coal. Seventeen out of the 21 elementary districts with no BASE levies do have over BASE levies.

All elementary districts with GTB mills above 60 have significantly increasing enrollment. Since the subsidy per mill is determined by the prior year's GTB area, the formula requires a higher guarantee level and fewer mills from districts with declining enrollments (decreasing GTB areas) and a lower guarantee level and more mills than it does from districts with increasing enrollments. This anomaly that may be acceptable to tax equity, as it is temporary.

Options for further improving tax equity

If the council wished to improve the tax equity of BASE mill levies beyond removing HB124 block grants, it could consider ways to change one of the two main reasons for tax inequity described on page 3:

- Non-Levy Revenue:
Further increase the “shared percentage” by removing all other remaining non-levy tax revenue sources and redistribute this revenue to schools. The types of revenue that would be included are: oil and gas, coal, and reimbursements (HB 20 and SB 417) that are currently phasing out. Interest, other district sources are not significant source for any district.
- GTB percentage:
Increase the GTB percentage in the BASE area. The higher the GTB percentage (currently 175% of average), the more districts will qualify for GTB aid which will leaving fewer districts with significantly lower mills.

Section 2: Redistribution of the HB124 Block Grants

The council could consider several items as methods of redistributing the \$25.5 million state savings from elimination of the HB124 block grants.

Increasing the GTB percentage

The council could chose to use the block grant revenue for achieving better tax equity by increasing the GTB percentage to 225%. This would further improve tax equity among districts. It would also spend the remaining \$25.5 million per year of the district general fund block grants.

Table 3 is similar to Table 2 and describes the tax equity improvements of increasing the GTB percentage to 225%.

Number of Districts at Various BASE Mill Levy Levels

Table 3

Mills	Elementary		High School	
	Remove HB124	Remove HB124 + increase GTB to 225%	Remove HB124	Remove HB124 + increase GTB to 225%
Zero	21	21	1	1
1-10	22	24	8	10
10-20	32	35	10	23
20-30	32	45	50	131
30-40	35	100	96	0
40-50	69	106		
50-60	115	6		
over 60	11	0		

With the increased GTB percentage, there is a further narrowing and lowering of the range of mills levied by elementary and high school districts.

The council could chose a lower GTB such as 200% and the results would be between the two examples in Table 3. The cost of a proposal that would increase the GTB percentage to 200% would be \$14.3 million. This would leave about \$11.2 million for any other school funding proposals that the council might consider.

Other school funding issues

The council could choose to use the remaining block grants revenue to address specific concerns in the funding formula. Some of the areas the council has shown interest in funding include: declining enrollments, or disproportionate funding between elementary schools and high schools.

Conclusion:

If the HB 124 block grants are removed, all districts will pay additional taxes to replace the revenue lost. Some districts will lose relatively more revenue than others. Any option that is chosen to return the \$25.5 million back to districts through the school funding formula will not return the same revenue to the same districts that lost the revenue. There will be winners and losers, but tax levels will be more equal.

Issues and options

1. Does the council want to discontinue the HB 124 block grants to school district general fund budgets and use these funds to enhance tax equity and address other funding issues?
2. Should part or all of the \$25.5 million remaining reduction in cost be used to:
 - increase the GTB percentage,
 - address declining enrollments, and/or
 - make other improvements in the funding formula?
3. Does the Council wish to pursue reductions in other non-levy revenue sources (oil, gas, coal, and reimbursements) to further improve tax equity?